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CASE STUDY: Investing in MTN Group

In order to provide our clients with greater insight into our investment views and how they develop over time, as well as the resultant active trading, we offer the following example of MTN Group (MTN), the Pan-African mobile communications operator. Here we outline the genesis of the investment case and our decision to add more MTN exposure to client portfolios during the height of the Coronavirus market crash, such that it is today a top-five overweight position in many of our client portfolios, and one in which we continue to have high conviction.

MTN operations

MTN operates across 21 countries, the key markets being South Africa, Nigeria and Ghana, with a focus on Africa, but also currently has a presence in four Middle East markets. MTN has either a number 1 or 2 subscriber share in all of these markets, and is transitioning its revenue base from voice to data, fintech services (mobile payments, lending and insurance) and digital services (messaging, social media, user-generated content and advertising). With its well-invested and superior quality infrastructure assets and platforms, MTN is uniquely positioned to meet the explosive growth in data traffic and an accelerating mobile and digital economy in Africa.

Background

During much of 2018, our funds were underweight MTN due to concerns about the prior year's devaluation of the Nigerian naira and the weaker consumer environment having a negative impact on MTN's Nigerian business' profitability and cash flow. The naira devaluation meant any cash flows repatriated to MTN Group head office from MTN Nigeria represented less value in rand and US$ terms. This was problematic for MTN investors, because the Group needed to service its debt balance at a holding company level (approximately half of which at the time was denominated in US$), and was going to be unable to sustain its prior year's minimum dividend declared of R7 per share without the MTN Nigeria cash flows.

This underweight position proved fortuitous at the end of August 2018, when we witnessed MTN's share price collapse from R110 to R70 over the space of two weeks. This sell-off was the result of a dispute with the Central Bank of Nigeria (CBN) which challenged the authorisation of prior dividends the company repatriated, as well as a claim for underpayment of tax by the Nigerian Attorney General (AG). Despite management's assertion that these matters were without merit and that MTN intended to defend itself in court, the market reaction was extreme, with the Group's market capitalisation losing over R6 billion shortly after the news broke. The quantum of the share price move led us to close our underweight position and establish a modest overweight position in November 2018, which we maintained during 2019, with the CBN and AG matters being resolved in MTN's favour over the period.

Covid-19 and weak oil price impact

Going into 2020, we were already approximately 1.5% overweight MTN, and as news unfolded of the rapid spread of the Coronavirus and implementation of lockdowns across the globe in March 2020, the oil price started to fall, along with global equity markets. Oil remains an all-important source of foreign revenue for Nigeria, and with the oil price having collapsed to below US$30 per barrel, there were market concerns about the risk of a further sharp devaluation in the naira. This led to an even larger fall in the MTN share price than we experienced in September 2018, with the share price in March 2020 falling below R35.

Scenario analysis

We recognised that a devaluation of the naira would result in a lower rand value being attributable to the MTN Nigeria operation, impacting Nigeria's contribution to Group earnings, and that a scarcity of hard currency liquidity in Nigeria would impede MTN's ability to upstream cash flows from Nigeria, hence restricting MTN's ability to service its debt held at the centre. However, we were confident that the Group's underlying assets were collectively worth more than the prevailing share price, and believed its South African operations alone underpinned the R35 share price.

In order to give ourselves comfort before adding to our existing position, we undertook a scenario analysis of MTN's "sum of the parts" valuation, assessing what the value of each of its underlying operations and assets would be worth under a worst-case scenario. This dire approach included taking a 30% discount to the market values of both its Nigeria and Ghana businesses, using lower valuation multiples for its Middle East operating companies, and attributing zero value to its IHS Towerco investment (its 29% shareholding is carried on the balance sheet at R27 billion, with over 50% of the IHS towers located in Nigeria). In addition, we focused on the cash flow generation of MTN South Africa, and concluded that the Group would be able to continue to service its full debt obligations *from South Africa alone*, although this would require MTN Group to suspend its dividend.

We were confident that our MTN sum of the parts valuation still had upside to over R100 per share, but that even with the more conservative assumptions outlined above, the share was worth at least R75. As a result, we bought aggressively in late March and early April 2020, at an average purchase price of R40, increasing our active position to 2.75% overweight. This additional buying made us one of the top-five shareholders in the company.

Valuation multiples and current view

The March 2020 price fall had resulted in MTN's valuation multiples signalling a level of cheapness we had never previously observed. It was trading at a 25% discount to its book value, and the Group's EV/Ebitda multiple fell below 3.0X relative to its long-run median of just over 5.5X.

As of the first week of May 2021, the MTN share price has recovered to R99, but still trades on a lower rating than it did historically. Yet with the recovery in the oil price, fears of a large devaluation of the naira have abated, such that the market is again willing to attribute some value to both MTN Nigeria and the IHS Towerco investment. While the share price has now exceeded our R75 worst-case scenario valuation, the outlook for MTN has materially improved, with management announcing a new "Ambition 2025" strategy that seeks to unlock value from both its own tower assets and fast-growing fintech platform (mobile money). The profitability outlook continues to look good for MTN as increased economic activity resulting from the opening up of the economies across the Continent following the hard lockdown has led to a recovery in demand for voice and continued higher demand for data and mobile money solutions.

Conclusion

We retain our high-conviction overweight position in MTN, while acknowledging that the stock can be volatile as a result of unexpected events and news driving its share price as well as sensitivity to the prevailing oil price. However, our analysis does still show an upside to the current share price of at least 30%. Meaningful value is to be realised from the proposed listing of IHS Towerco on the New York Stock Exchange, expected to take place during this year (challenging market conditions stalled the listing during 2020). Proceeds from a sell-down of its IHS Towerco holdings post-listing will enable a significant paydown of the company's US$ debt, with further release of capital coming from the sale and lease-back of its SA towers portfolio. Finally, we are most excited about the new strategy to establish a separate holding company for MTN's fast-growing mobile money platform, which deserves to attract a higher valuation multiple than the mature GSM operations out of which it has developed. The counter remains an important part of many of our client portfolios as a result.

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